AR78

2004 Annual Report

# Welton

ENERGY CORPORATION

Welton is managed, in part, by executives and employees of the Brompton Group of Companies. Brompton is regarded as one of the finest and most highly respected providers of financial products and management services to individual and institutional clients in Canada.

## A COMMITMENT TO EXCELLENCE

Through a disciplined commitment to excellence, Brompton has grown its assets under management to over $2.2 billion in less than three years, establishing a solid foundation that will continue to deliver strong returns to its investors and clients. Brompton's success has been achieved by offering investments to the public which combine excellent value, integrity and superior performance. Brompton's management and directors are a well respected group of accomplished business leaders who maintain the highest levels of corporate governance. The extensive experience, track record and integrity of its people are Brompton's most valuable assets.

**Notice of Annual General Meeting**
Shareholders are cordially invited to attend the Annual General Meeting of Welton Energy Corporation on Tuesday, May 17, 2005 at 10:00 a.m. at the Roxie Theatre, Sun Life Plaza Conference Centre, 2nd level (plus 15), 140 – 4th Avenue SW, Calgary, Alberta.

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# Corporate Profile

Welton Energy Corporation is a growth oriented junior energy company that is focused on the exploration, development and production of natural gas. The Company commenced its energy operations following the acquisition of Welton Energy Limited, a small private oil company, on August 29, 2003, at which time the name of the Company was changed to its current form to reflect its new business plan. The management of the Company includes principals of the Brompton Group of Companies and other senior managers and business executives who have successfully built and operated oil and gas companies in the past.

The Company's business strategy is to achieve growth in production and cash flow through the completion of significant transactions, including joint ventures, property purchases and corporate acquisitions, and through drilling success from opportunities arising from such transactions. Welton's unique business approach includes partnering with proven operators, which allows the Company to keep costs low and to focus on what its management does best – finding, structuring and negotiating accretive transactions.

A cornerstone of Welton's strategy is its risk management philosophy that seeks to achieve the Company's objectives through a diversified portfolio of projects that range from high impact exploration to low-risk exploitation plays with a focus on shallower, lower cost opportunities which have multi-zone potential. The Company seeks to manage its risk exposure so that it can comfortably participate in enough projects to provide the statistically probable outcome.

The Company is committed to increasing shareholder value and, like all Brompton managed entities, to the application of high standards of business practice and strong corporate governance.

# Financial Highlights

| (in thousands except per share and boe amounts) | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| **Oil and gas revenues** | $ 745 | $ 803 | $ 1,642 | $ 1,101 | $ 4,291 |
| **Cash flow from operations**[1] | | | | | |
| Per share – basic | $ 0.02 | $ 0.01 | $ 0.05 | $ 0.03 | $ 0.12 |
| Per share – diluted | 0.02 | 0.01 | 0.05 | 0.02 | 0.11 |
| **Income (loss)** | | | | | |
| Per share – basic | $ 0.04 | $ (0.01) | $ 0.03 | $ 0.08 | $ 0.14 |
| Per share – diluted | 0.04 | (0.01) | 0.03 | 0.07 | 0.13 |
| **Capital expenditures** | $ 5,688 | $ 534 | $ 2,148 | $ 2,650 | $ 11,020 |
| **Shares outstanding** | | | | | |
| Weighted average – basic | 13,662 | 16,002 | 16,532 | 18,034 | 16,064 |
| Weighted average – diluted | 14,632 | 17,182 | 17,306 | 19,170 | 17,086 |
| **Production** | | | | | |
| Oil and NGLs (bbls/d) | 226 | 259 | 316 | 155 | 239 |
| Natural gas (mcf/d) | 225 | 93 | 736 | 766 | 457 |
| Total (boe/d)[2] | 264 | 275 | 438 | 283 | 315 |
| **Gross (net) wells drilled** | 4 (1.1) | – (–) | 4 (1.8) | 5 (2.1) | 13 (5.0) |
| Oil | 1 (0.4) | – (–) | – (–) | – (–) | 1 (0.4) |
| Gas | – (–) | – (–) | 2 (1.1) | 4 (1.6) | 6 (2.7) |
| Standing | – (–) | – (–) | 1 (0.2) | – (–) | 1 (0.2) |
| Dry and abandoned | 3 (0.7) | – (–) | 1 (0.5) | 1 (0.5) | 5 (1.7) |

(1) Cash flow as presented (before changes in non-cash working capital) does not have any standardized meaning prescribed by Canadian GAAP and therefore it may not be comparable with the calculation of similar measures for other entities.

(2) Boe may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a boe conversion ratio for natural gas of 6 mcf to 1 bbl has been used. This ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency of the representative commodity at the wellhead.

# Message to Shareholders

> We are pleased to report on the operations and financial position of Welton Energy Corporation for the year ended December 31, 2004.

Over the past year, Welton has made considerable progress in building its production base and expanding its portfolio of drilling opportunities. Five new core areas of operations were added, all located in the multi-horizon gas prone regions north of Edmonton and west of the fifth meridian. These new opportunities range from lower risk exploitation-type plays to higher risk and higher potential exploration prospects. In each case, Welton has secured a meaningful land position to provide additional upside from drilling success. These steps, coupled with the significant tax pools of the Company, position Welton for potential growth in cash flow and corresponding increases in shareholder value.

**Significant Transactions**

Through 2004, Welton participated in four new joint exploration and/or development projects and made one significant disposition of producing properties.

*Patry*

In February 2004, Welton entered into a joint exploration program with Lightning Energy Ltd. covering 36 townships near Fort Nelson in northeast British Columbia. The primary objective has been a resource natural gas play that offers significant production and reserve growth potential for Welton. The first well in this program is planned to be drilled in early 2006.

*Woking*

Welton entered into another joint exploration program with Lightning, also in February 2004, covering four townships located southwest of the Company's Peace River Arch project. As part of the transaction, Welton acquired a 25% working interest in 17 sections of land. One well was drilled in this program in 2004, and while it encountered multiple prospective zones, none proved to be commercially viable and the well will be abandoned. A second well is planned for this region in the second quarter of 2005.

*Karr*

Welton acquired an average 25% working interest in 34 sections of land in the Karr area of northwest Alberta in March 2004. Included in the transaction was a shut-in liquids rich natural gas well in which Welton has a 75% working interest until payout of its entire capital in the project plus a bonus of $750,000. Thereafter, its interest in the well will be 40%. The well was brought back into production at the end of July and has produced at a sustained rate of 225 to 240 boe/d net to the Company.

*Majeau*

In the third quarter of the year, Welton entered into a joint exploration program with Golden Eagle Energy Ltd. covering 28 townships in the Majeau area located northwest of Edmonton. This was our most active project during the year, which included drilling four new wells, resulting in three successful gas wells and one dry hole. Several additional locations have been identified and nine wells are budgeted to be drilled in 2005.

### *Sale of Acclaim Operated Production*

The Company sold its interest in the Acclaim Energy Trust operated properties to Acclaim in October 2004. These properties were fully developed and were considered not to be core assets to the Company. Welton realized a profit of $1.4 million on the sale and the proceeds were used to repay our note financing that was borrowed to acquire the Karr assets and to fund our successful Majeau drilling and completion program.

### Drilling

During the year, Welton participated in the drilling and/or re-completion of 13 wells (gross) resulting in seven successful wells and five dry holes (one well is still under evaluation) for an overall success ratio of 54% gross (61% net). Four of the successful wells validated new exploration concepts that will lead to future drilling opportunities. Given that the drilling program was weighted towards exploration where the likely outcome is a dry hole, we are pleased with the success of our 2004 drilling program.

### Production

Welton's production averaged 315 boe/d in 2004, the Company's first full year of oil and gas operations. This was achieved after taking into account the sale of our Acclaim operated production in October 2004. This sale represented 250 boe/d of production net to Welton. At year end, the Company had approximately 300 boe/d of net productive capacity behind pipe and waiting for facilities construction and pipeline tie-in. At the time of writing, most of the construction work has been completed and approximately 90 boe/d of this new capacity has been brought into production.

### Financing

A critical element to a successful investment in a junior oil and gas company is the company's management of its capital needs. In 2004, the Company incurred capital spending of $11.0 million. This program was successfully financed through the issue of flow-through shares, a note financing and by proceeds from the sale of non-core assets. The note financing was repaid from the proceeds of the asset sale. Each equity financing was done at a price that was either at or higher than the price of the previous equity offering, which helped to reduce the impact of dilution to the shareholders.

Entering 2005, the Company is debt free and has a strong cash flow capability to finance much of Welton's capital spending plans for the coming year. The Company also has tax pools totalling over $28 million which will allow it to access cheaper flow-through share financing, if needed.

### Listing

In 2004, the Company announced its intention to provide a listing for its common shares. Steps were taken to simplify the Company's shareholdings through approvals obtained at the special meeting of shareholders held in November 2004. Approval was obtained to convert the Company's special non-voting shares to common shares and to subsequently consolidate the number of common shares of the Company. We are pleased to report that all of the non-voting shares were converted into common shares and that the number of outstanding shares was consolidated on a 10-for-1 basis prior to year end. The number of common shares of Welton outstanding at year end totalled 23.4 million.

# Message to Shareholders (cont'd)

An application to list the common shares of the Company on the TSX requires the completion of the year end audited financial statements and the receipt of an independent engineering report on the Company's reserves. We expect that the listing will be obtained in the second quarter of 2005.

**Management**

With our success in increasing the scope of Welton's operations, we have added to our management ranks and now have a technical team capable of allowing Welton to be a full-cycle exploration and development company. We would like to thank our employees for their contribution to the success we have been able to achieve in 2004.

**Outlook**

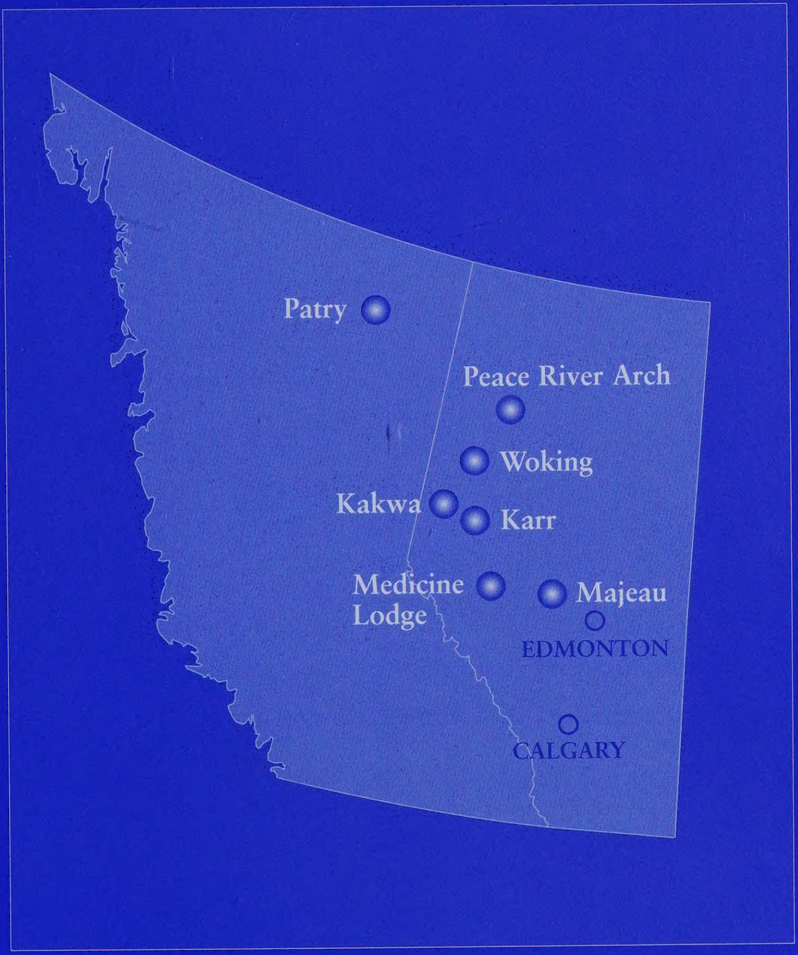
Welton's primary goal is to increase shareholder value through profitable growth over the long term. Since commencing oil and gas operations less than 1½ years ago, Welton has successfully built its land and drilling opportunity inventory to fuel future growth. The Company's management team has been strengthened to provide full-cycle expertise and better control over our activities. Welton's growing cash flow from operations, which may be supplemented by acquisitions or other significant transactions, will help finance ongoing drilling opportunities.

Respectfully submitted on behalf of the Board of Directors,

**Raymond R. Pether**
*Chief Executive Officer*

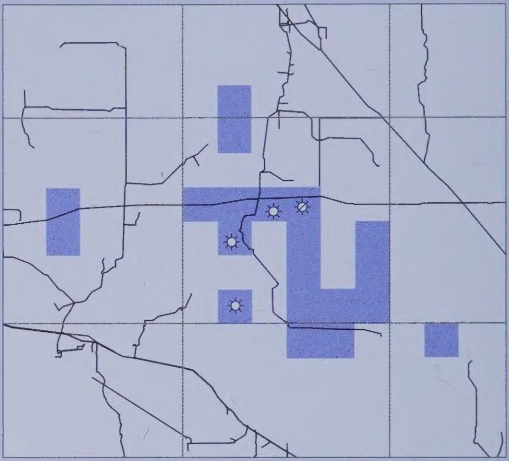
**Donald A. Engle**
*President*

March 28, 2005



Welton Energy Corporation's current land holdings exceed 89,000 gross (19,000 net) acres in seven core areas in Alberta and British Columbia. All of Welton's land holdings are in multi-horizon gas prone areas. New opportunities range from lower risk exploitation plays to higher risk and higher potential exploration prospects.

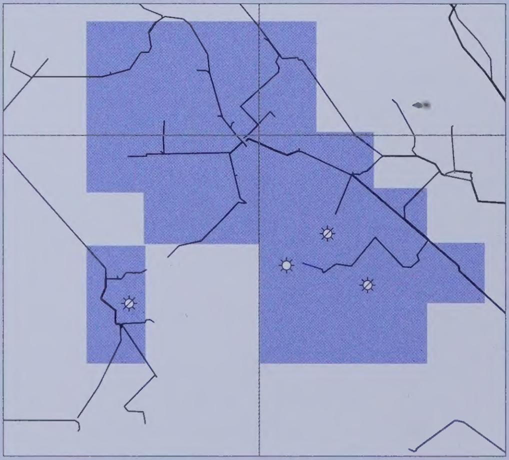
### Majeau, Alberta



The Majeau project is located northwest of Edmonton. It provides multi-zone potential with nearby production from the shallow Belly River sands, Cretaceous aged sands and in the Viking and Mannville, and the Mississippian Banff formation. Pursuant to a joint exploration arrangement with Golden Eagle Energy Ltd. covering 28 townships, Welton acquired a 50% working interest in eight gross sections of land and the opportunity to participate for a 50% working interest in future prospects in the area. One additional section was acquired and another earned during 2004, resulting in a total land position at year end of 6,400 gross (2,800 net) acres. Subsequently, Welton has acquired interests in additional lands and currently owns 12,800 gross (6,000 net) acres.

Most of the production in the area is gas from the Belly River and Mannville sands and oil from the Banff at depths from 300 metres to 1,350 metres. Gas transportation and processing capacity is available nearby and the area has year-round access. Banff tests to 1,350 metres can be drilled and cased for under $400,000. Typical Mannville gas wells will produce 1 to 3 mmcf/d and recover 1 to 5 bcf of gas with the potential of 10 bcf pools. Welton believes this area has significant upside for the Company and has assumed the role as operator of all drilling and completion activities.

During late 2004, Welton drilled four wells in the area, two have been tied-in and placed on production and a third is waiting for compressor installation to start production. We have developed an active program in the area for 2005 and have budgeted to drill nine gross (3.6 net) wells of the 13 potential locations identified. A 3D seismic program will also be shot in 2005.



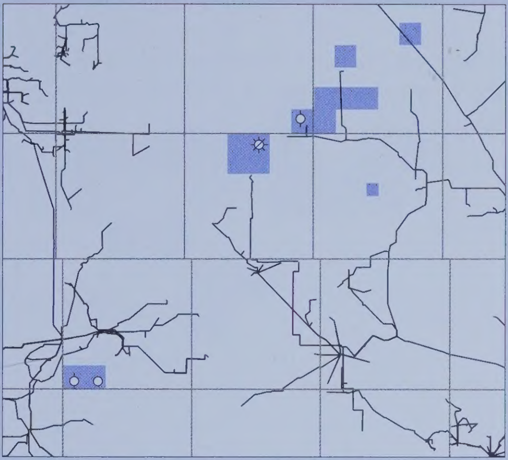
### Karr, Alberta

Karr is a multi-zone property with exploration and development potential for both sweet and sour gas. Zones of interest include the Cadotte, Dunvegan, Bluesky, Gething and Wabamun. This acquisition included 34 gross sections of primarily 20% to 75% working interest lands, four well bores and a 20% interest in a central compressor dehydration facility. Before payout, Welton benefits from a 75% working interest in the liquid rich gas well. Payout is defined to include the total cost of Welton's initial acquisition at Karr plus its portion of the completion and facility repair capital and a $750,000 bonus payout. After payout, our interest will be 40%. This well has produced a steady 225 to 240 boe/d since starting up in July 2004. Welton has an interest in 17,280 gross (4,448 net) acres of land in this area.

Development potential exists in two of the purchased well bores. One of these wells is near the central compressor and was shut-in due to high water cuts in a low gas price environment. Restarting this well is scheduled for the second quarter. The second well has tested over 11.0 mmcf/d of liquid rich sour gas but is isolated from sour gas processing facilities by a large river. Considering current gas prices, logistics for connecting this well are being reviewed and we hope to act on this later this year.

Two exploration prospects have also been identified. These wells are being considered for the third quarter.

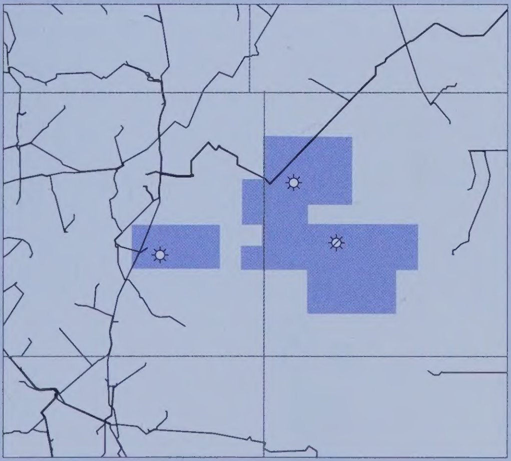
**Peace River Arch, Alberta**



Our Peace River Arch project is a broad multi-objective play area with several potential structural and stratigraphic traps. This area has multi-zone potential ranging from 600 metres to 1,650 metres. The area also has developed infrastructure with available capacity. The primary zone of interest is the Kiskatinaw. At a depth of about 1,400 metres, the Kiskatinaw wells in the region produce at rates of 1 to 5 mmscf/d and recover 2 to 7 bcf per well from this zone. The cost to drill and case a well is about $650,000.

The project area, which is located about 120 km north of Grande Prairie and has year-round access, includes Pica, Blueberry, and Oak. Pursuant to a joint exploration agreement with Lightning Energy Ltd., which covers a 25 township area, Welton has the right to participate on a non-promoted basis for 25% of Lightning's interest in all activities in the project area. Welton has an interest in 8,480 gross (2,312 net) acres of land in this area.

Welton participated in the drilling of two gross (0.575 net) Kiskatinaw wells and one gross (0.25 net) Notikewin well in 2004. One well tested 0.6 mmscf/d and the other two were dry holes. Locations were selected with the use of 2D seismic. Re-interpretation of the seismic with each well result has improved our understanding of the play's geophysical characteristics. A 3D seismic program is planned for the area and at least one well is planned to be drilled in 2005.



**Kakwa, Alberta**

Kakwa is a multi-zone deep basin property just west of Karr that we acquired in late 2004 through a unique farm-in opportunity. The farm-in well flowed while drilling and has 22 metres of pay with significant reserve potential based on analog wells. We participated at a 26.5% before payout working interest (19% after payout) on the completion and earned six and a half sections of land, subject to a continuation application. Additional lands included in the deal give Welton an interest in 7,520 gross (917 net) acres of land and two additional well bores.

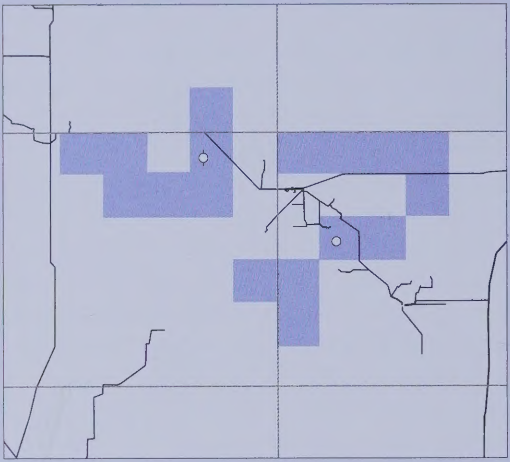
The well tested at 0.5 mmcf/d and is expected to be connected for production this summer. Review of these results and the newly acquired land base is ongoing and a 3D seismic program may be warranted.

○ Location

⫰ Waiting on Completion

☼ Gas Well – Producing

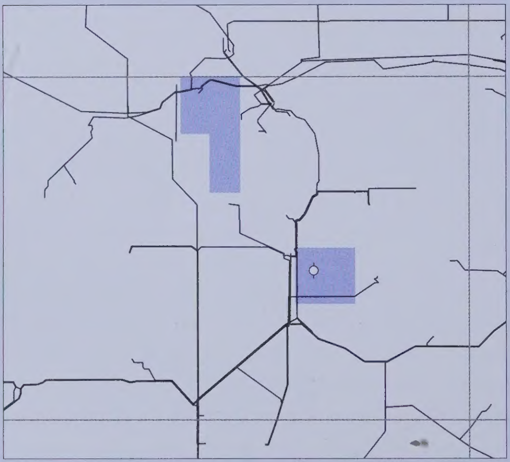
⊘ Gas Well – Suspended



### Woking, Alberta

The Woking project is targeting shallow by-passed light sweet gas in a four township area of mutual interest located south of the Company's Peace River Arch project. Pursuant to the joint venture agreement, Welton acquired a 25% working interest in 17 sections of land already owned by Lightning. The primary exploration target of this program has the potential to produce at rates of 0.75 to 1 mmcf/d and carry reserves in the 1 to 3 bcf range for each well drilled. Welton has an interest in 10,880 gross (2,720 net) acres in this area.

Welton is participating as to its 25% interest in a Basal Gething test well in the second quarter of 2005. The estimated cost to drill and case the well is about $600,000 ($150,000 net).



### Medicine Lodge, Alberta

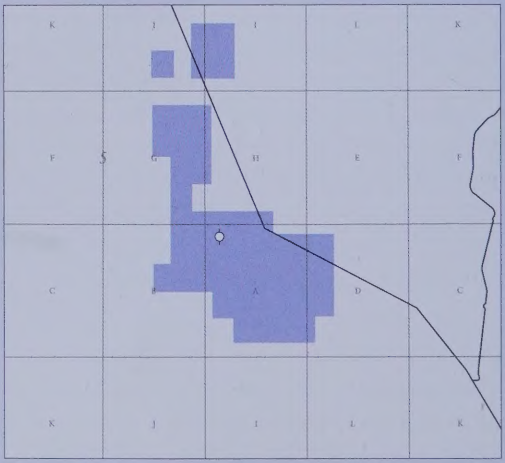
The Medicine Lodge area in west central Alberta is located approximately 210 km west of Edmonton. This area has multi-zone potential for natural gas from as many as eight pay zones. Exploration targets include Cretaceous Viking, Cardium and Cadomin, and the Devonian Wabamun, at depths ranging from 2,400 to 3,700 metres. The area also has developed infrastructure with available capacity. Welton has interests in approximately 1,600 gross (608 net) acres of land.

The cost to drill and case a Cretaceous well is about $1,200,000.

### Patry, British Columbia

Patry is a high impact area near Fort Nelson, British Columbia. The primary target has the potential to produce 5 to 10 mmcf/d and carry reserves of 5 to 15 bcf. This project is part of a 36 township exploration project with Lightning. Welton holds an interest in 30,035 gross (2,330 net) acres in this area.

Welton anticipates drilling a well in this area in late 2005 or early 2006.



## Land

Welton has accumulated a significant land position in seven project areas – six in Alberta and one in northeast British Columbia. Land holdings at fiscal year end 2004 were approximately 82,000 gross and 16,000 net acres. As our land holdings are significant in each project area, there is potential for meaningful growth from this diversified portfolio. All of our project areas are characterized by having multi-zone potential in order to manage the risks associated with exploration and development activities. Competitor activity around our holdings is also increasing and appears successful.

## 2004 Land Inventory

As at December 31, 2004, the Company's land inventory included the following:

| | Developed Acres | | Undeveloped Acres | | Total Acres | |
|---|---|---|---|---|---|---|
| Core Area | Gross | Net | Gross | Net | Gross | Net |
| **Alberta** | | | | | | |
| Majeau | 2,560 | 1,200 | 3,840 | 1,600 | 6,400 | 2,800 |
| Karr | 2,560 | 1,120 | 14,720 | 3,328 | 17,280 | 4,448 |
| Peace River Arch | 1,920 | 528 | 6,560 | 1,784 | 8,480 | 2,312 |
| Kakwa | 1,920 | 196 | 5,600 | 721 | 7,520 | 917 |
| Woking | 640 | 160 | 10,240 | 2,560 | 10,880 | 2,720 |
| Medicine Lodge | 640 | 128 | 960 | 480 | 1,600 | 608 |
| **British Columbia** | | | | | | |
| Patry | 652 | 90 | 29,383 | 2,241 | 30,035 | 2,331 |
| Total | 10,892 | 3,422 | 71,303 | 12,714 | 82,195 | 16,136 |

Net average reflects the Company's working interest in the reported gross acreage.

# Reserves

## Reserves Estimates

Welton's reserves were evaluated by the independent engineering firm of Gilbert Laustsen Jung Associates Ltd. ("GLJ") as at December 31, 2004.

Reserve estimates have been calculated in compliance with National Instrument 51-101 ("NI 51-101") which defines proved reserves as having a 90% probability that actual reserves recovered over time will equal or exceed proved reserve estimates. Probable reserves under NI 51-101 are defined to have 50% probability that actual reserves recovered will be greater or less than the proved plus probable estimate.

Reserve reports were prepared using GLJ's forecast for prices and exchange rates as shown in the table below.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| WTI Oil (US$ bbl) | 42.00 | 40.00 | 38.00 | 36.00 | 34.00 | 33.00 | 33.00 | 33.00 | 33.50 | 34.00 |
| Plant gate gas (Cdn$/mmbtu) | 6.35 | 6.10 | 5.90 | 5.75 | 5.75 | 5.75 | 5.75 | 5.75 | 5.85 | 5.95 |
| Exchange rates (Cdn/US) | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 | 0.82 |

The following table reports Welton's reserves as at December 31, 2004 based on GLJ's forecast for prices and exchange rates. Gross reserves do not account for any royalties owed on such production and net reserves have been adjusted for royalties. Future net cash flow includes the Alberta royalty tax credit which is applicable to producing wells in Alberta and well abandonment costs. Income taxes have not been included in these figures since the Company's non-capital losses exceed future net cash flow.

| | Natural Gas (mmcf) | | Natural Gas Liquids (mbbls) | | Total (mboe) | | Future Net Cash Flow ($000's, discounted) | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net | 0% | 10% | 12% | 15% |
| Proved | 1,471 | 1,189 | 42 | 37 | 287 | 235 | 6,184 | 4,873 | 4,691 | 4,448 |
| Probable | 1,158 | 976 | 25 | 21 | 218 | 184 | 4,524 | 2,977 | 2,798 | 2,571 |
| Total | 2,629 | 2,165 | 67 | 58 | 505 | 419 | 10,708 | 7,850 | 7,489 | 7,019 |

Reserve reports were also prepared using constant dollar reference prices which reflect prices in effect on December 31, 2004. The WTI oil reference price was US$43.45 per barrel, plant gate natural gas was $6.54 per mmbtu and condensate was $48.97 per barrel.

| | Constant Prices | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Natural Gas (mmcf) | | Natural Gas Liquids (mbbls) | | Total (mboe) | | Future Net Cash Flow ($000's, discounted) | | | |
| | Gross | Net | Gross | Net | Gross | Net | 0% | 10% | 12% | 15% |
| Proved | 1,483 | 1,199 | 42 | 37 | 289 | 237 | 6,960 | 5,345 | 5,128 | 4,842 |
| Probable | 1,168 | 981 | 25 | 21 | 220 | 185 | 5,164 | 3,353 | 3,147 | 2,885 |
| Total | 2,651 | 2,180 | 67 | 58 | 509 | 422 | 12,124 | 8,698 | 8,275 | 7,727 |

The following table reports the Company's working interest reserves by principal product type using GLJ's forecast for prices and exchange rates.

### Reconciliation of Company Net Reserves by Principal Product Type Forecast Prices and Costs

|  | Light and Medium Oil |  |  | Heavy Oil |  |  | Conventional Natural Gas |  |  | Natural Gas Liquids |  |  | BOE |  |  |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Factors | Net Proved (mbbl) | Net Probable (mbbl) | Net Proved Plus Probable (mbbl) | Net Proved (mbbl) | Net Probable (mbbl) | Net Proved Plus Probable (mbbl) | Net Proved (mmcf) | Net Probable (mmcf) | Net Proved Plus Probable (mmcf) | Net Proved (mbbl) | Net Probable (mbbl) | Net Proved Plus Probable (mbbl) | Net Proved (mboe) | Net Probable (mboe) | Net Proved Plus Probable (mboe) |
| January 1, 2004 | 126 | 17 | 143 | 153 | 14 | 167 | 149 | 10 | 159 | – | – | – | 304 | 33 | 337 |
| Extensions | – | – | – | – | – | – | 599 | 298 | 897 | 6 | 3 | 9 | 106 | 53 | 159 |
| Improved recovery | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Technical revisions | – | – | – | – | – | – | – | – | – | – | – |  | (1) | – | – |
| Discoveries | – | – | – | – | – | – | 514 | 298 | 812 | 20 | 2 | 22 | 106 | 52 | 157 |
| Acquisitions | – | – | – | – | – | – | 243 | 380 | 623 | 27 | 16 | 43 | 68 | 79 | 147 |
| Dispositions | (98) | (17) | (115) | (110) | (14) | (124) | (149) | (10) | (159) | – | – | – | (233) | (33) | (266) |
| Economic factors | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – |
| Production | (28) | – | (28) | (43) | – | (43) | (167) | – | (167) | (16) | – | (16) | (115) | – | (115) |
| January 1, 2005 | – | – | – | – | – | – | 1,189 | 976 | 2,165 | 37 | 21 | 58 | 235 | 184 | 419 |

Acquisitions refer to reserves provided by the Karr shut-in well and dispositions reflect the sale of assets to Acclaim.

Additional reserve disclosure tables, as required under NI 51-101, are available on SEDAR pursuant to the Company's filing of form 51-101 F1.

# Management's Discussion and Analysis

The following supplementary information provides an analysis of the operations and financial position of the Company and it should be read in conjunction with the December 31, 2004 audited financial statements. This commentary is based on information available to March 28, 2005.

Boe amounts have been calculated using a conversion rate of 6 mcf of natural gas to 1 bbl of oil. To facilitate the comparability of the figures presented in this analysis, share and per share figures have been adjusted to reflect the 10-for-1 common share consolidation which occurred on December 30, 2004.

## PRODUCTION

For 2004, the Company produced an average of 315 boe/d comprised of 239 bbl/d of oil and NGLs and 76 boe/d of natural gas. The following table sets out the average daily production values by quarter.

| | Q1 | Q2 | Q3 | Q4 | Annual |
|---|---|---|---|---|---|
| Oil (bbl/d) | 222 | 259 | 241 | 57 | 194 |
| Natural gas liquids (bbl/d) | 4 | – | 75 | 98 | 45 |
| Natural gas (mcf/d) | 225 | 93 | 736 | 766 | 457 |
| Total boe/d | 264 | 275 | 438 | 283 | 315 |

Production during the year was influenced by two significant events. The first was the acquisition of our natural gas liquids rich well at Karr that was restarted in July 2004. After an initial period of clean-up, the well has demonstrated a sustained production rate of 225 to 240 boe/d. This well increased average daily production of natural gas and corresponding liquids significantly during the second half of the year. In the fourth quarter, production was interrupted for two weeks to rectify mechanical problems associated with the well's facilities.

The other major event that affected Welton's production was the sale of the Company's Acclaim operated properties to Acclaim that closed on October 22, 2004. These properties were fully exploited and therefore considered non-core to the Company. As a result of this sale, oil production in the fourth quarter was substantially reduced.

### Drilling Summary

In 2004, Welton participated in 13 gross (5.03 net) wells with a net 61% success rate. Of the 13 wells, four (1.99 net) are producing, three (1.09 net) are waiting on facilities, one is standing and awaiting final evaluation and five (1.75 net) were dry. Considering that more than half of Welton's drilling activity was exploration activity, the results were satisfactory.

| 2004 Summary | Drilled | Successful | Standing | Dry |
|---|---|---|---|---|
| Gross | 13 | 7 | 1 | 5 |
| Net | 5.03 | 3.08 | 0.2 | 1.75 |

### Capital Expenditures

Net capital expenditures for 2004 amounted to $7.1 million (2003 – $4.5 million) comprising total capital expenditures of $11.0 million and dispositions of $3.9 million. Much of the capital spending activity during the early part of the year was associated with building the Company's oil and gas exploration development opportunities including payments towards land acquisitions from and joint ventures with Lightning Energy Limited for the Woking, Patry and Karr project areas. A further joint venture exploration project was entered into with Golden Eagle Energy Ltd. These initiatives contributed to increased exploration and development drilling during the third and fourth quarters.

| Capital Expenditures (thousands) | Q1 | Q2 | Q3 | Q4 | 2004 | 2003 |
|---|---|---|---|---|---|---|
| Exploration drilling | $ 417 | $ 226 | $ 817 | $ 982 | $ 2,442 | $ – |
| Development drilling | 552 | 39 | 22 | 710 | 1,323 | 489 |
| Production equipment | 1,444 | 227 | 89 | 788 | 2,548 | 66 |
| Land and joint venture payments | 3,275 | 2 | 1,216 | 170 | 4,663 | 1,000 |
| Dispositions/acquisitions | – | – | – | (3,904) | (3,904) | 2,722 |
| Other | – | 40 | 4 | – | 44 | – |
| Total | $ 5,688 | $ 534 | $ 2,148 | $ (1,254) | $ 7,116 | $ 4,277 |

The major project initiatives during 2004 are summarized below.

*Lightning Energy Limited Joint Venture*

In February 2004, the Company entered into two joint exploration agreements with Lightning. Pursuant to each of these agreements, Welton paid $1.0 million to earn a 25% working interest in certain pre-acquired lands and they provide Welton with the right to participate in 25% of Lightning's net working interest in all future opportunities within the exploration areas. The exploration area under the first agreement covers 36 townships and is located in northeast British Columbia. The exploration area under the second agreement covers four townships and includes 17 sections of land in the Woking area south of the Company's Peace River Arch joint venture.

In March 2004, the Company entered into another agreement with Lightning, whereby the Company paid $2 million to earn a 40% working interest in 34 gross sections of land in the Karr area of northwest Alberta and a 20% interest in the Karr compression and dehydration facility. Before payout, the Company receives a 75% working interest in a liquid rich gas well. After payout, the working interest on that well will be 40%. The up-front capital payment noted above, the incremental capital costs over and above 40% of the costs of the well reactivation, a second completion and the facility repair, two wells and a bonus of $750,000 are all included in the amount required to reach payout.

In August 2004, the Company farmed into a drilling prospect in the Medicine Lodge area of Alberta and purchased an interest in additional land in the area.

In late 2003, the Company entered into its first joint venture with Lightning. Under this agreement, Welton paid $1.0 million to earn a 25% working interest in certain pre-acquired lands and provided Welton with the right to participate in 25% of Lightning's net working interest in all future opportunities within the exploration area, which cover 25 townships in the Peace River Arch area of Alberta.

### *Golden Eagle Energy Limited Joint Venture*

In the third quarter, the Company entered into a joint exploration arrangement with Golden Eagle that covers a 28 township area in the Majeau region of Alberta. Pursuant to this three-year arrangement Welton paid Golden Eagle $1.0 million for a 50% interest in the land held by Golden Eagle and the opportunity to participate on an equal basis in any new prospect in the project area.

### *Acclaim Energy Inc. Joint Venture*

On October 22, 2004, the Company completed the sale of its interest in 17 producing gross wells (11 net wells) to the operator, Acclaim Energy Trust. The Company sold its interests for $4.6 million and recorded a gain on the sale of $1.4 million. These assets had been acquired through the acquisitions of Welton Energy Limited in August 2003 and ExplorFund 2001 Ltd. in November 2003. At the time of the sale, these wells were producing approximately 250 boe/d. The assets were fully developed and considered non-core by the Company. Proceeds from the sale allowed the Company to repay $1.4 million in remaining notes outstanding which would have been due in February 2005. The remaining proceeds have been available to fund the Company's expenditures with Golden Eagle and Lightning.

## Liquidity and Capital Resources

### *Share Capital and Flow-through Share Financings*

During 2004, the Company completed two flow-through share financings, raising gross proceeds of $4.5 million and issuing a total of 4 million common shares. Related parties subscribed for 410,000 of these shares. The second financing occurred in December and shares were issued at $1.50 which was a 50% premium to the first financing which occurred in March. The proceeds from these financings have been used to fund the Company's capital expenditures.

In an effort to simplify the existing share structure and to facilitate a future listing of shares on a stock exchange, at the annual general meeting held in November, the Company recommended and shareholders approved the reclassification of the non-voting special shares into common shares. As a result, the 4.4 million issued and outstanding special shares were converted into common shares and the non-voting special shares were removed from the authorized capital of the Company. As well, shareholders approved a consolidation of the Company's common shares and, on December 30, 2004, the common shares were consolidated on a 10-for-1 basis so that there were 23.4 million common shares outstanding.

### *Loan and Note Financings*

In 2004, the Company also raised $3.5 million of capital through the issuance of one-year 6% secured notes ("Notes"). The Notes were issued in the first quarter and each $1.00 of Notes entitled the holder to 0.625 warrants and each warrant entitled the holder to purchase one common share of the Company at $0.80 per share. Related parties subscribed for $2.55 million of this issue. This financing was used primarily to repay the $570,000 loan which was outstanding at the end of 2003 and to fund Welton's participation in the Woking and Patry joint ventures with Lightning. By the end of 2004, the Notes had all been repaid using the proceeds from the sale of the Acclaim properties and with proceeds received from the exercise of warrants. In an effort to induce the early exercise of the warrants issued with the Notes, the Board of Directors had approved a resolution to allow warrantholders to exercise at $0.70 per share rather than $0.80. The exercise of the warrants raised $1.4 million for the Company.

### *Working Capital*

On December 31, 2004, the Company had positive working capital of $827,000 (2003 – ($326,000)) primarily as a result of a $1.5 million flow-through share financing which occurred at the end of December.

*Contractual Obligations*
The Company has obligations to renounce qualifying tax deductions under the flow-through share agreements it has entered into as described in the Income Tax section.

*Off-balance Sheet Arrangements*
The Company has no off-balance sheet arrangements.

## FINANCIAL RESULTS

### Netbacks

The Company's netback from its oil and gas production for 2004 increased to $22.47 per boe from $15.49 per boe in 2003. The following table provides a breakdown of the netback for each quarter of 2004.

| | Q1 | Q2 | Q3 | Q4 | 2004 | 2003 |
|---|---|---|---|---|---|---|
| Oil, NGL & natural gas revenues | $ 31.49 | $ 31.57 | $ 40.17 | $ 43.23 | $ 37.19 | $ 29.44 |
| Royalty expense, net of ARTC | (7.66) | (8.55) | (5.99) | (2.36) | (6.07) | (8.93) |
| Production expenses | (7.42) | (5.68) | (9.63) | (11.13) | (8.65) | (5.02) |
| Netback | $ 16.41 | $ 17.34 | $ 24.55 | $ 29.74 | $ 22.47 | $ 15.49 |

In 2004, the Company enjoyed the benefit of higher oil prices when compared to 2003 as West Texas Intermediate ("WTI") oil prices averaged US$41.44 per bbl in 2004 (2003 – US$30.40 per bbl). The Company's production for 2004 was primarily weighted to oil as shown in the earlier production table and revenues reflect the discount to WTI for oil quality differentials. The netback per boe increased significantly in the third quarter and continued into the fourth quarter as a result of NGL production from the Karr well. Over these two quarters, Karr produced NGLs at a rate of approximately 86 bbl/d net to Welton at an average price of $52.48/bbl. Royalty expenses per boe decreased in the third quarter and further in the fourth quarter primarily as a result of the benefit of an Alberta Crown gas royalty holiday from the Karr well. Royalties incurred in the fourth quarter are a result of production from the Acclaim operated wells up to the date of closing of the sale of assets.

Production expenses increased in the third and fourth quarters due to higher operating costs of the Karr well and facility.

### General and Administrative Expenses

General and administrative expenses for the year were $667,000 or $5.78 per boe (2003 – $158,000). The 2003 expenses were over a four-month period, beginning at the date of acquisition of Welton Energy Limited. Included in general and administrative expenses were costs of $101,000 which were paid to Brompton Limited, a related party. Brompton Limited is entitled to recover costs in providing senior management services, accounting and administrative staff, office space, supplies and office equipment.

### Interest Expense

During the year, a total of $141,000 (2003 – $13,000) of interest was paid by the Company on its Notes and loans. The Notes, which bore interest at 6% per annum, were issued on February 13, 2004 and were repaid in two parts in September and October 2004 using proceeds from the exercise of warrants issued with the Notes and from the proceeds of the sale of the Acclaim assets.

### Depletion, Depreciation and Accretion

Depletion of the Company's oil and gas properties amounted to $1.5 million or $13.26 per boe. The ceiling test calculation for the current year, which uses undiscounted cash flow and third party reference prices, indicated surpluses relative to the carrying value of the Company's property, plant and equipment.

At December 31, 2004, the Company had recorded an asset retirement obligation of $98,000. This amount is the net present value of the total future asset retirement costs of $135,000. The total costs were estimated by management based on the Company's working interest in its wells, estimated costs to abandon and reclaim those wells and the estimated timing of the costs to be incurred in future periods.

### Income Taxes

The Company does not have any current income tax expense as it has non-capital loss carryforwards of $22.5 million. These losses will expire over five years from 2006 to 2010. As at December 31, 2004, the Company had Canadian exploration expenses of $2.6 million available for future deduction or renunciation, Canadian development expenses of $250,000, Canadian oil and gas property expenses of $1.8 million, and undepreciated capital costs of $1.5 million available for future deduction.

For the year ended 2003, the Company had renounced $1.4 million in qualifying tax deductions to its investors. In March 2004 and December 2004, another $4.5 million in flow-through financing was issued and the Company has until the end of 2005 to incur approximately $1.8 million in qualifying expenditures to satisfy these obligations.

### Income

Income for the year was $2.2 million (2003 – ($299,000)) or $0.13 (2003 – ($0.07)) per diluted share. Income included a gain of $1.4 million on the sale of the Acclaim assets which was recorded in the fourth quarter and a recovery of future income taxes in the amount of $517,000. The use of non-capital losses to offset future income tax liabilities resulting from the renunciations of the $1.4 million of 2003 flow-through share issuances gave rise to the future tax recovery.

### Discontinued Operations

The Company's previous investment and consulting business has been accounted for in the financial statements as discontinued operations. The 2003 loss from discontinued operations of $338,000 was comprised primarily of a $300,000 writedown of investments in the second quarter.

### Selected Annual Financial Information

| (thousands, except per share amounts) | 2004 | 2003 | 2002 |
|---|---|---|---|
| Total revenue | $ 5,706 | $ 479 | $ – |
| Income before discontinued operations | 2,192 | 39 | – |
| Net income (loss) | 2,192 | (299) | (2,687) |
| Per share amounts: | | | |
| Basic | | | |
| Income before discontinued operations | 0.14 | 0.01 | – |
| Net income (loss) | 0.14 | (0.07) | (0.10) |
| Diluted | | | |
| Income before discontinued operations | 0.13 | 0.01 | – |
| Net income (loss) | 0.13 | (0.07) | (0.10) |
| Total assets | $ 14,179 | $ 5,525 | $ 447 |

### Selected Quarterly Financial Information

| 2004 | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Total revenue | $ 755 | $ 812 | $ 1,650 | $ 2,489 |
| Income (loss) before discontinued operations | 560 | (95) | 538 | 1,189 |
| Net income (loss) | 560 | (95) | 538 | 1,189 |
| Per share amounts: | | | | |
| Basic | | | | |
| Income before discontinued operations | 0.04 | (0.01) | 0.03 | 0.08 |
| Net income (loss) | 0.04 | (0.01) | 0.03 | 0.08 |
| Diluted | | | | |
| Income before discontinued operations | 0.04 | (0.01) | 0.03 | 0.07 |
| Net income (loss) | $ 0.04 | $ (0.01) | $ 0.03 | $ 0.07 |

| 2003 | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Total revenue | $ – | $ – | $ 96 | $ 377 |
| Income (loss) before discontinued operations | – | – | (33) | 61 |
| Net income (loss) | (32) | (360) | 35 | 47 |
| Per share amounts – basic & diluted: | | | | |
| Income before discontinued operations | – | – | – | – |
| Net loss | $ – | $ (0.07) | $ – | $ – |

### Accounting Pronouncements

Effective January 1, 2004, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented for comparative purposes. Previously, the Company recognized a provision for future site restoration costs over the life of the oil and gas properties using a unit-of-production method.

As a result of this change, the opening deficit for 2004 and the loss for the period ended December 31, 2003 decreased by $11,000. The asset retirement obligations increased by $190,000 and property, plant and equipment increased by $201,000.

### Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires management to make certain judgements and estimates. Changes in these judgements and estimates could have a material impact on the Company's financial results and financial condition. The process of estimating reserves is critical to several accounting estimates. The process of estimating reserves is complex and requires significant judgements and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development and production activities becomes available and as economic conditions impacting oil and natural gas prices, operating costs and royalty burdens change. Reserve estimates impact net income through depletion. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income.

## BUSINESS RISK ASSESSMENT

There are a number of inherent risks associated with oil and gas operations and development. Many of these risks are beyond the control of management. The following discussion outlines some of the principal risks and their impact on the Company.

### Drilling Risk

Exploration and development drilling has significant risk that the desired outcome will not be achieved. The most likely outcome of most exploration drilling is an unsuccessful well. Welton attempts to mitigate drilling risk by having a diversified portfolio of prospects that are focused on shallower, lower cost opportunities that have multi-zone potential. The Company seeks to participate in enough wells so that the statistically probable outcome of success is more likely to occur.

### Capital Spending

The Company may be required to raise additional debt or equity financing to meet its capital spending plans.

### Reliance on Joint Venture Operators

The Company does not operate most of its development and exploration projects. Therefore, the Company has significantly less control over the timing and cost efficiency of its non-operating programs. The Company attempts to mitigate this risk by maintaining a close and active relationship with its operating partners.

### Commodity Prices

The Company's oil and gas prices are affected by a variety of factors such as supply and demand for the commodity, quality, exchange rates and transportation accessibility. Commodity prices have fluctuated dramatically over the past year. The Company does not currently have any commodity price hedges in place.

### Exchange Rates

The importance of exchange rates to Welton's profitability is underscored by the fact that crude oil is sold against a US dollar reference price, while the majority of operating costs are denominated in Canadian dollars.

### Environmental

The Company is responsible for its share of environmental, abandonment and reclamation costs of its wells and facilities in accordance with environmental and government regulations. The Company maintains insurance for environmental risks, however, there is no guarantee that the coverage will be sufficient to cover all environmental claims.

### Reservoir

Future cash flows are dependent on the availability of the estimated reserves. While reserves and production estimates are prepared by a professional independent engineering firm that specializes in preparing such estimates, reservoir performance subsequent to the date of the estimate may result in revisions, either upward or downward, to reserves and production rates.

## OUTLOOK

Welton's primary goal is to increase shareholder value through profitable growth over the long term. Since commencing oil and gas operations less than 1½ years ago, Welton has successfully built its land and drilling opportunity inventory to fuel future growth. The Company's management team has been strengthened to provide full-cycle expertise and better control over its activities. Welton's growing cash flow from operations will help finance ongoing drilling opportunities which may be supplemented, from time to time, by acquisitions and other significant transactions.

## FORWARD-LOOKING STATEMENTS

This report contains certain "forward-looking statements" within the meaning of such statements under applicable securities law. Forward-looking statements are frequently characterized by words such as "plan", "expect", "estimate", "believe" and other similar words, or statements that certain events or conditions "may" or "will" occur. By their nature, forward-looking statements involve assumptions and are subject to a variety of risks and uncertainties, including, but not limited to, those associated with resource definition, the possibility of project cost overruns or unanticipated costs and expenses, regulatory approvals, fluctuating oil and gas prices, and the ability to access sufficient capital to finance future development. Although the Company believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. The Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements as a result of new information, future events or otherwise, subsequent to the date of this report. The reader is cautioned not to place undue reliance on forward-looking statements.

Additional information relating to the Company can be found on its website at www.weltonenergy.com or through the SEDAR system at www.sedar.com.

# Management's Report

The financial statements of the Company are the responsibility of management and the Board of Directors of the Company. They have been prepared by management in accordance with Canadian generally accepted accounting principles.

In fulfilling its responsibilities, management has developed and maintains a system of internal controls designed to safeguard assets from loss or unauthorized use and ensure the accuracy of the financial records. The financial statements necessarily include certain estimates which are made after consideration of the information available and using careful judgements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee which is comprised of directors who are not employees of the Company. The Committee meets with management and the external auditors to satisfy itself that the responsibilities of the respective parties are properly discharged and to review the financial statements before they are presented to the Board for approval.

The shareholders have appointed PricewaterhouseCoopers LLP, as the external auditors of the Company, in that capacity, they have examined the financial statements for the year ended December 31, 2004. The Auditors' Report to the shareholders is presented herein.

**Raymond R. Pether**
*Chief Executive Officer*

**Mark A. Caranci**
*Chief Financial Officer*

# Auditors' Report

To the Shareholders of Welton Energy Corporation:

We have audited the balance sheet of Welton Energy Corporation (the "Company") as at December 31, 2004 and the statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2003 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 10, 2004.

PricewaterhouseCoopers LLP

**PricewaterhouseCoopers LLP**
*Chartered Accountants*

Calgary, Alberta
February 25, 2005

# Balance Sheet

As at December 31
(in thousands of dollars)

| | 2004 | 2003 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | $ 2,642 | $ 496 |
| Accounts receivable | 803 | 289 |
| Deposits and prepaid expenses (note 5) | 146 | 407 |
| | 3,591 | 1,192 |
| **Property, plant and equipment** (note 6) | 10,588 | 4,333 |
| | $ 14,179 | $ 5,525 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | $ 2,764 | $ 932 |
| Income taxes payable | – | 16 |
| Due to related party (notes 8 & 12) | – | 570 |
| | 2,764 | 1,518 |
| **Asset retirement obligation** (note 7) | 98 | 207 |
| | 2,862 | 1,725 |
| **Shareholders' equity** (note 10) | 11,317 | 3,800 |
| | $ 14,179 | $ 5,525 |

Approved on behalf of the Board of Directors:

**Peter L. Wallace**
*Lead Director*

**Aubrey W. Baillie**
*Director*

The accompanying notes are an integral part of these financial statements.

# Statement of Operations and Deficit

For the years ended December 31
(in thousands of dollars, except per share amounts)

| | 2004 | 2003 |
|---|---|---|
| **Revenues** | | |
| Production | $ 4,291 | $ 473 |
| Royalty expense | (701) | (144) |
| Gain on sale of assets (note 6) | 1,352 | – |
| Other income | 63 | 6 |
| | 5,005 | 335 |
| **Expenses** | | |
| Depletion, depreciation and accretion | 1,544 | 151 |
| Production | 998 | 86 |
| General and administrative | 667 | 158 |
| Interest and bank charges | 141 | 13 |
| | 3,350 | 408 |
| **Income (loss) from continuing operations before income tax** | 1,655 | (73) |
| **Income taxes** (note 9) | | |
| Current income tax recovery | 20 | – |
| Future income tax recovery | 517 | 112 |
| | 537 | 112 |
| **Income from continuing operations** | 2,192 | 39 |
| **Loss from discontinued operations** (note 1) | – | (338) |
| **Income (loss)** | 2,192 | (299) |
| **Deficit, beginning of year** | (6,371) | (53,067) |
| **Reduction in stated capital** (note 10) | – | 47,000 |
| **Dividends on special shares** (note 10) | (12) | (5) |
| **Deficit, end of year** | $ (4,191) | $ (6,371) |
| **Income from continuing operations per common share – basic** (note 10) | $ 0.14 | $ 0.01 |
| **– diluted** (note 10) | $ 0.13 | $ 0.01 |
| **Income (loss) per common share – basic** (note 10) | $ 0.14 | $ (0.07) |
| **– diluted** (note 10) | $ 0.13 | $ (0.07) |

The accompanying notes are an integral part of these financial statements.

# Statement of Cash Flows

For the years ended December 31
(in thousands of dollars)

| | 2004 | 2003 |
|---|---|---|
| **Cash flows related to the following activities:** | | |
| Operating | | |
| Income from continuing operations | $ 2,192 | $ 39 |
| Adjustments for: | | |
| Gain on sale of assets | (1,352) | – |
| Depletion, depreciation and accretion | 1,544 | 151 |
| Future income taxes | (517) | (112) |
| Cash flow from continuing operations | 1,867 | 78 |
| Cash flow from discontinued operations | – | 56 |
| Cash flow | 1,867 | 134 |
| Changes in non-cash working capital | 1,287 | 379 |
| Cash provided by operating activities | 3,154 | 513 |
| Financing | | |
| Issuance of common shares (note 10) | 1,422 | 500 |
| Issuance of special shares (note 10) | 270 | – |
| Issuance of notes (note 8) | 3,500 | – |
| Repayment of notes (note 8) | (3,500) | – |
| Issuance of flow-through shares, net (note 10) | 4,161 | 1,400 |
| Repayment/advances to/from related party (notes 8 & 12) | (570) | 570 |
| Dividends paid on special shares (note 10) | (17) | – |
| Cash provided by financing activities | 5,266 | 2,470 |
| Investing | | |
| Business combination with Welton Energy Limited (note 4) | – | (925) |
| Business combination with ExplorFund 2001 Ltd. (note 4) | – | 258 |
| Oil and natural gas property expenditures | (11,020) | (1,555) |
| Proceeds from disposition of assets | 4,465 | – |
| Changes in non-cash investing working capital | 281 | (271) |
| Cash used in investing activities | (6,274) | (2,493) |
| **Net increase in cash** | 2,146 | 490 |
| **Cash, beginning of year** | 496 | 6 |
| **Cash, end of year** | $ 2,642 | $ 496 |
| **Supplementary information:** | | |
| Interest paid | $ 147 | $ 7 |
| Taxes paid | $ 16 | $ – |

The accompanying notes are an integral part of these financial statements.

# Notes to the Financial Statements

December 31, 2004 and 2003
(in thousands except per share amounts)

## 1. OPERATIONS

On August 28, 2003, shareholders of The NRG Group Inc. ("NRG") approved the acquisition of all of the issued and outstanding common shares of Welton Energy Limited, a private company engaged in the exploration, development, and production of oil and natural gas in Canada. An amendment to the Articles of NRG was also approved at that time to rename NRG to Welton Energy Corporation ("Welton" or the "Company").

Subsequent to the acquisition of Welton Energy Limited on August 29, 2003, the Company engaged in the exploration, development and production of oil and natural gas in Canada and is no longer actively involved in the investment business. Until the acquisition, NRG was focused on investments in the technology sector. Accordingly, operations of the investment business prior to the acquisition have been accounted for as discontinued operations. The loss from discontinued operations in 2003 includes a writedown in an investment in the amount of $300.

On December 30, 2004, the Company consolidated the issued and outstanding common shares on a 10-for-1 basis. All common shares, special shares, warrants, options and earnings per share in these financial statements and notes have been adjusted to reflect this consolidation.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

**Oil and gas properties**

The Company follows the full cost method of accounting wherein all costs related to the exploration for and the development of oil and natural gas reserves are capitalized and accumulated in one cost centre. Proceeds received from the disposal of properties are normally credited against accumulated costs unless this would result in a twenty percent change in the depletion rate, in which case a gain or loss is computed and reflected in the statement of operations.

The provision for depletion and depreciation of oil and gas properties is provided on the unit-of-production method based upon the Company's estimated proven oil and gas reserves before royalties. Natural gas reserves are converted to common units based on the approximate equivalent energy content of each unit of reserves, which results in a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil.

Impairment of the Company's oil and gas properties is recognized if the carrying amount of the properties exceeds the sum of the undiscounted cash flows expected to result from the Company's proved reserves. Cash flows are calculated based on third party quoted forward prices, adjusted for the Company's contracted prices and quality differentials.

Upon recognition of impairment, the Company measures the amount of impairment by comparing the carrying amounts of its oil and gas properties to an amount equal to the fair value of the properties. The fair value is estimated to be the net present value of future cash flows from proved plus risked probable reserves using a risk-free interest rate. Any excess carrying value above the fair value of the Company's future cash flows is charged to income in the period.

The cost of unproved properties is excluded from the impairment or ceiling test calculation and subject to a separate impairment test.

**Joint ventures**

The Company's exploration, development and production activities are conducted in joint participation with others, and the accounts reflect only the Company's proportionate interest in such activities.

**Asset retirement obligation**

The asset retirement obligation liability is initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the obligation is settled. The fair value is capitalized as part of the related asset and is depleted over the useful life of the asset.

**Income taxes**

The Company uses the liability method of accounting for income taxes. Under this method, the Company records future income tax assets and liabilities based on the differences between the book value and the income tax value of an asset or liability using substantially enacted income tax rates.

**Flow-through shares**

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. The Company records the carrying value of the expenditures in petroleum and natural gas properties as incurred and on renunciation, records a future income tax liability in relation to the benefits renounced with a corresponding reduction to share capital.

**Revenue recognition**

Revenue associated with the sales of the Company's natural gas, natural gas liquids and crude oil is recognized when title passes from the Company to its customer.

**Earnings (loss) per share**

Basic earnings (loss) per share has been determined by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated based on the treasury method using the weighted average number of common shares outstanding during the period adjusted for the potential dilution that could occur if the outstanding stock options were exercised at the beginning of the period (or at the time of issuance, if later) and the funds obtained from exercise were used to purchase common shares for cancellation.

**Stock-based compensation plan**

Effective January 1, 2003, the Company elected to prospectively adopt the fair value method of accounting for options granted subsequent to January 1, 2003 under its stock-based compensation plan as recommended by the Canadian Institute of Chartered Accountants. The fair value calculated related to stock options granted on or after January 1, 2003 is deferred and charged against earnings, as compensation expense, over the vesting period of the stock options with a corresponding increase in contributed surplus. The related compensation expense is included in general and administrative expense.

Consideration paid to the Company upon the exercise of the stock options is recorded as an increase to share capital, and an adjustment is made to transfer to share capital the compensation expense previously recognized in contributed surplus for the specific stock options exercised.

The Company has not incorporated an estimated forfeiture rate for stock options in determining the stock option fair value in order to calculate its compensation expense, as the Company has assumed that all stock options granted will vest. Accordingly, forfeitures are accounted for as they occur and are treated as a change in estimate. The cumulative effect of the change on current and prior periods is recognized in the period of the change in estimate. In the event that vested options expire without being exercised, previously recognized compensation costs associated with such stock options are not reversed.

The Company's stock-based compensation plan is described in Note 11.

**Financial instruments**

The carrying values of financial instruments, including cash, accounts receivable, deposits, accounts payable and accrued liabilities, approximate the fair value due to their short maturities.

**Measurement uncertainty**

The preparation of timely financial statements necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. These estimates will affect assets, liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as revenues and expenses during the reporting periods. Such estimates are based on informed judgements made by management. Actual results could differ materially from those estimated.

Amounts recorded for depletion and depreciation, future site restoration and amounts used for ceiling test calculations are based on estimates of oil and natural gas reserves which include estimates of future commodity prices, future costs and other relevant assumptions. The Company's reserves are estimated and evaluated annually by an independent engineering firm. By their nature, these estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact of changes in such estimates on the consolidated financial statements of future periods could be material.

## 3. CHANGE IN ACCOUNTING POLICY

Effective January 1, 2004, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations" ("ARO"). This change in accounting policy has been applied retroactively with restatement of prior periods presented for comparative purposes. Previously, the Company recognized a provision for future site restoration costs over the life of the oil and gas properties using a unit-of-production method.

As a result of this change, the opening deficit for 2004 and the loss for the period ended December 31, 2003 decreased by $11. The ARO increased by $190 and property, plant and equipment increased by $201.

## 4. BUSINESS COMBINATIONS

**Acquisition of Welton Energy Limited**

On August 29, 2003, the Company completed the acquisition of all of the issued and outstanding common shares of Welton Energy Limited ("WEL"). The acquisition was accounted for using the purchase method of accounting with the results of operations of WEL included in the financial statements from the date of acquisition. The allocation of the purchase price to the fair value of the assets acquired and liabilities assumed was as follows:

| Allocation of purchase price: | | |
|---|---|---|
| Net working capital | $ | 405 |
| Oil and natural gas properties | | 1,223 |
| | $ | 1,628 |

| Consideration was comprised of: | | |
|---|---|---|
| Issuance of 3,861 special shares at $0.02 per share | $ | 677 |
| Cash – $7.40 per WEL common share | | 923 |
| Transaction costs | | 28 |
| | $ | 1,628 |

The acquisition was financed through a private placement of common shares of $500 at $0.20 per share (note 10) and a loan of $565 from a related party (note 12).

Net working capital includes cash of $26. As part of the acquisition, the Company recognized $1,050 of previously unrecognized non-capital loss carryforwards which offset future tax liabilities of WEL.

On September 4, 2003, WEL was wound-up into the Company and dissolved.

**Acquisition of ExplorFund 2001 Ltd.**

On November 19, 2003, the Company completed the acquisition of all of the issued and outstanding common shares of ExplorFund 2001 Ltd. ("Explorfund"). The acquisition was accounted for using the purchase method of accounting with the results of operations of Explorfund included in the financial statements from the date of acquisition. The allocation of the purchase price to the fair value of the assets acquired and liabilities assumed was as follows:

| Allocation of purchase price: | | |
|---|---|---|
| Net working capital | $ | 30 |
| Oil and natural gas properties | | 1,499 |
| | $ | 1,529 |

| Consideration was comprised of: | | |
|---|---|---|
| Issuance of 4,700 common shares | $ | 1,503 |
| Transaction costs | | 26 |
| | $ | 1,529 |

The value assigned to the common shares issued was established based on the estimated fair value of the asset acquired and liabilities assumed.

Net working capital includes cash of $258. As part of the acquisition, the Company recognized $1,567 of previously unrecognized non-capital loss carryforwards which offset future tax liabilities of Explorfund.

On November 24, 2003, Explorfund was wound-up into the Company and dissolved.

## 5. DEPOSITS AND PREPAID EXPENSES

In certain situations the Company is required to fund capital expenditures in advance of the work being done on such projects. At year end, $106 (2003 – $387) was on deposit with third party operators to be applied as payment against future work on applicable projects.

## 6. PROPERTY, PLANT AND EQUIPMENT

| | 2004 | 2003 |
|---|---|---|
| Oil and gas properties | $ 3,830 | $ 3,164 |
| Undeveloped land and joint venture payments | 5,665 | 1,003 |
| Seismic data | 128 | 68 |
| Production equipment | 2,024 | 243 |
| Other | 44 | – |
| | 11,691 | 4,478 |
| Accumulated depletion and depreciation | (1,103) | (145) |
| | $ 10,588 | $ 4,333 |

On October 22, 2004, the Company closed the sale of its oil and gas properties operated by Acclaim Energy Trust ("Acclaim") to Acclaim for proceeds of $4,600 less purchase adjustments of $154. The sale was effective October 1, 2004 and the Company recorded a gain of $1,352 on the sale.

The calculation of the 2004 depletion and depreciation excludes $3,410 (2003 – $1,003) for undeveloped properties and $260 (2003 – $115) for the estimated salvage value of production equipment.

The table below sets out the benchmark commodity price assumptions used in each of the next five years for purposes of the impairment test. Prices were adjusted for applicable differences in each commodity and applicable transportation for each of the properties and the inflation rate in subsequent years was 2.0% per year.

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| West Texas Intermediate Crude Oil at Cushing, Oklahoma (US$/bbl) | 42.00 | 40.00 | 38.00 | 36.00 | 34.00 |
| Natural Gas Alberta Plant Gate (Cdn$/mmbtu) | 6.35 | 6.10 | 5.90 | 5.75 | 5.75 |
| Natural Gas Liquids at Edmonton ($Cdn/LT) | 50.75 | 48.25 | 46.00 | 43.75 | 41.25 |

## 7. ASSET RETIREMENT OBLIGATION

The asset retirement obligation was estimated by management based on the net present value of the Company's share of its wells, estimated costs to abandon and reclaim those wells and the estimated timing of the costs to be incurred in future periods. The Company has estimated its asset retirement obligation to be $98 based on a total future liability of $135. These costs are expected to be incurred over 12 years.

| | 2004 | 2003 |
|---|---|---|
| Opening balance | $ 207 | $ – |
| Increase in liability during period | 97 | 201 |
| Decrease in liability from sale of assets | (220) | – |
| Accretion expense | 14 | 6 |
| Balance, December 31 | $ 98 | $ 207 |

## 8. NOTES PAYABLE

On February 13, 2004, the Company issued $3,500 of one-year 6% secured notes ("Notes"). Each dollar in Notes issued entitles the holder to 0.625 warrants, and each warrant is exercisable into common shares of the Company at $0.80 per common share at any time prior to February 13, 2006. A total of 2,188 warrants were issued pursuant to this financing. Brompton Financial Limited ("BFL"), a significant shareholder, purchased $2,500 of these Notes and a director of the Company purchased $50. A portion of the proceeds from these Notes was used to retire the loan payable to BFL of $570.

On August 24, 2004, in an effort to induce the early exercise of these warrants thereby providing capital to the Company, the Board of Directors approved a resolution to allow warrantholders to exercise their warrants at $0.70 per common share provided they exercised the warrants immediately. On September 7, 2004, warrantholders exercised 2,031 warrants at this reduced rate for proceeds of $1,422, the proceeds of which were used to reduce the Notes outstanding. BFL exercised 1,563 warrants and a director of the Company exercised 31 warrants.

## 9. INCOME TAXES

The provision for income taxes differs from the result that would be obtained by applying the combined current year Canadian federal and provincial income tax rates of approximately 40.76% (2003 – 42.30%) to the earnings before taxes. The difference results from the following items:

| For the year ended December 31 | 2004 | 2003 |
|---|---|---|
| Income (loss) before income taxes | $ 1,655 | $ (411) |
| Income taxes computed at statutory rates | 675 | (174) |
| Effect on income tax of: | | |
| Non-deductible crown charges and resource allowance | (252) | 67 |
| Tax benefit of unrecognized loss carryforward | (940) | – |
| Other | (20) | (5) |
| Income tax recovery | $ (537) | $ (112) |

The tax effects of temporary differences that give rise to the future income tax assets and liabilities are presented below:

| As at December 31 | 2004 | 2003 |
|---|---|---|
| Future income tax assets | | |
| Share issuance costs | $ 160 | $ 194 |
| Loss carryforwards | 6,668 | 9,042 |
| Other | 9 | – |
| Valuation allowance | (5,732) | (8,553) |
| Future income tax liabilities | | |
| Property and equipment | (1,105) | (683) |
| Net future income taxes | $ – | $ – |

The Company has total non-capital loss carryforwards of $22,513 (2003 – $24,466). No future income tax benefits have been recorded for $18,496 (2003 – $22,922) of this amount. The loss carryforwards expire in 2006 to 2010. As at December 31, 2004 the Company had Canadian exploration expenses of $2,610 available for future deduction or renunciation, Canadian development expenses of $250, Canadian oil and gas property expenses of $1,804 and undepreciated capital costs of $1,461 available for future deduction.

## 10. SHARE CAPITAL

Shares in the table below have been adjusted to reflect the 10-for-1 consolidation on December 30, 2004.

**Authorized**
An unlimited number of common shares with no par value.

**Issued and Outstanding**

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | Number | Amount | Number | Amount |
| **Common shares** | | | | |
| Opening balance | 13,003 | $ 4,004 | 2,803 | $ 47,637 |
| Shares issued on private placement | – | – | 2,500 | 500 |
| Shares issued on acquisition of Explorfund | – | – | 4,700 | 1,503 |
| Flow-through shares issued | 4,000 | 4,161 | 3,000 | 1,400 |
| Shares issued on exercise of warrants | 2,031 | 1,422 | – | – |
| Conversion of special shares | 4,386 | 947 | – | – |
| Tax effect of flow–through share renunciations | – | (517) | – | (36) |
| Reduction in stated capital | – | – | – | (47,000) |
| Closing balance | 23,420 | 10,017 | 13,003 | 4,004 |
| **Special shares** | | | | |
| Opening balance | 3,386 | 677 | – | – |
| Shares issued pursuant to acquisition of WEL | – | – | 3,386 | 677 |
| Shares issued on exercise of warrants | 1,000 | 270 | – | – |
| Conversion to common shares | (4,386) | (947) | – | – |
| Closing balance | – | – | 3,386 | 677 |
| **Special share warrants** | | | | |
| Opening balance | 1,000 | – | – | – |
| Warrants issued pursuant to acquisition of WEL | – | – | 1,000 | – |
| Exercise of warrants | (1,000) | – | – | – |
| Closing balance | – | – | 1,000 | – |
| **Common share warrants** | | | | |
| Opening balance | – | – | – | – |
| Warrants issued pursuant to Notes | 2,188 | – | – | – |
| Warrants exercised | (2,031) | – | – | – |
| Closing balance | 157 | – | – | – |
| **Contributed surplus** | – | 5,491 | – | 5,490 |
| **Deficit** | – | (4,191) | – | (6,371) |
| **Total shareholders' equity** | | $ 11,317 | | $ 3,800 |

On August 28, 2003, the shareholders of the Company approved a reduction in the common share stated capital account by $47,000. An equal and offsetting adjustment was made to the Company's deficit.

In conjunction with the August 29, 2003 acquisition of the common shares and warrants of Welton Energy Limited, the Company issued 2,500 common shares at $0.20 per share by way of private placement and issued 3,386 special shares at $0.20 per share and 1,000 special share warrants exercisable at $0.27 per special share to the shareholders of Welton Energy Limited who elected to receive special shares instead of cash (see note 4).

On November 19, 2003, the Company issued 4,700 common shares to acquire all of the common shares of Explorfund (see note 4).

On November 14, 2003 and December 31, 2003, the Company issued through private placement, 2,500 and 500 flow-through common shares, respectively. The November 14, 2003 offering was completed at $0.40 per share for proceeds of $1,000 and the December 31, 2003 offering was completed at $0.80 per share for proceeds of $400.

On March 12, 2004, the Company issued 3,000 flow-through common shares at $1.00 per share for net proceeds after agents' fees and issue costs of $2,775.

On September 7, 2004, warrantholders exercised 2,031 of the warrants that were issued with the Notes at $0.70 per common share for proceeds of $1,422 (see note 8).

On November 30, 2004, all of the issued and outstanding special shares were reclassified into common shares and the special shares were removed from the authorized capital of the Company. In conjunction with the reclassification, the cumulative dividends on the special shares in the amount of $0.004 per share per annum were paid by the Company.

On December 23, 2004, the Company issued 1,000 flow-through common shares at $1.50 per share for net proceeds after agents' fees and issue costs of $1,386.

On December 30, 2004, the Company consolidated the issued and outstanding common shares on a 10-for-1 basis.

The basic and diluted weighted average numbers of common shares outstanding during the year were 16,064 (2003 – 4,542), and 17,086 (2003 – 4,615), respectively.

## 11. STOCK OPTION PLAN

On August 29, 2003, a stock option plan ("2003 Option Plan") became effective for the Company and replaced the previous stock option plan. All options outstanding under the previous plan were cancelled. Under the 2003 Option Plan, the Board of Directors may grant to any director, officer, employee or consultant, options to acquire common shares limited to the lesser of 5,000 common shares or 10% of the outstanding common shares of the Company. Options will vest at the discretion of the Board and the term shall not exceed five years from the date of grant. At the time an option is granted the Board will determine the exercise price of the option.

A summary of the changes and the Company's outstanding options is presented below. These figures have been adjusted for the 10-for-1 common share consolidation.

| | Number | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2002 | 98 | $ 20.40 |
| Granted | 1,150 | 0.36 |
| Exercised | – | – |
| Cancelled | (98) | (20.40) |
| Outstanding, December 31, 2003 | 1,150 | 0.36 |
| Granted | 450 | 1.00 |
| Exercised | – | – |
| Cancelled | – | – |
| Outstanding, December 31, 2004 | 1,600 | $ 0.54 |

A summary of the options outstanding under the Company's 2003 Option Plan as at December 31, 2004 is as follows:

| Exercise Price | Number of Options Outstanding | Expiry Date | Exercisable Options |
|---|---|---|---|
| $0.27 | 400 | September 9, 2008 | 133 |
| $0.40 | 750 | December 1, 2008 | 250 |
| $1.00 | 450 | June 1, 2009 | 75 |
| | 1,600 | | 458 |

The Company has used the fair value method to determine a fair value for stock options granted on or after January 1, 2003, in order to determine stock option compensation expense. The weighted average fair value of options granted during the year was $0.90 (2003 – $0.40) per share.

The fair value of each option granted after January 1, 2003 was determined on the date of the grant based on its minimum value which is computed as the current price of the stock reduced to exclude the present value of any expected dividends minus the present value of the exercise price. The minimum value was calculated using the following assumptions: current price of $0.90 (2003 – $0.20 and $0.40); discount rate 6% (2003 – 6%); and no dividends.

## 12. RELATED PARTY TRANSACTIONS

On March 12, 2004, the Company issued 3,000 flow-through common shares at $1.00 per share. Directors of the Company subscribed for 250 of these flow-through common shares.

On October 26, 2004, BFL exercised 1,000 special share warrants at $0.27 per share and received 1,000 special shares. On November 30, 2004 all of the issued and outstanding special shares of the Company were converted to common shares of the Company. BFL and a Director of the Company converted 4,338 special shares to common shares and received special share dividends of $17.

Directors and officers of the Company have been granted 1,590 (2003 – 1,140) stock options under the 2003 Stock Option Plan.

Subsequent to the acquisition of WEL in 2003, certain management functions of the Company have been provided by Brompton Limited ("BL"), the parent company of BFL. This includes the provision of certain senior management functions, certain accounting and administrative staff, office space, supplies and office equipment. Pursuant to this arrangement, BL is entitled to recover costs in providing these services. During the year, costs of $101 (2003 – $27) were charged by BL and as at December 31, 2004, $9 (2003 – $20) was payable to BL.

Prior to the issuance of the Notes, BFL agreed to lend the Company an amount up to $750. The loan was unsecured and bore interest at the prime rate plus 2% per annum and was repayable on demand. During the year, the Company recorded interest expense of $4 (2003 – $13) on this loan.

On August 29, 2003, the Company completed a private placement of 2,500 common shares at $0.20 per share of which 1,850 were purchased by directors of the Company.

Also in 2003, a director and officer of the Company was also a shareholder, director and officer of Explorfund and was issued 173 common shares in exchange for the 102 Explorfund common shares owned by him at the time of the acquisition.

Directors and officers of the Company, as well as BL subscribed for 1,230 and 56 flow-through common shares on the private placements on November 14, 2003 and December 31, 2003, respectively.

All related party transactions were recorded at the exchange amount in 2004 and 2003.

## 13. COMMITMENTS

At December 31, 2004, the Company has the following office lease commitments:

| | |
|---|---|
| 2005 | $ 66 |
| 2006 | 66 |
| 2007 | 50 |
| Total | $ 182 |

# Statement of Governance Practices

Welton Energy Corporation has adopted the TSX guidelines for corporate governance and will adopt the new standards set by the Ontario Securities Commission once they are finalized. We are pleased to report on Welton's governance practices as follows:

| **TSX Guidelines for Effective Corporate Governance** | | **Company Governance Practices** |
|---|---|---|
| 1. The board of directors of every corporation should explicitly assume responsibility for the stewardship of the corporation. | ✓ | The mandate of the board is to supervise the management of the Company and to act in the best interest of the Company. The board acts in accordance with:<br>• the Ontario Business Corporation Act<br>• the Company's articles of incorporation and by-laws<br>• the Company's code of business ethics<br>• the charters of the board and board committees<br>• other applicable laws and Company policies.<br>The board approves all significant decisions that affect the Company before they are implemented and reviews the results.<br>Copies of the Company's code of business ethics and charters of the board and its committees can be found on the Company's website at www.weltonenergy.com. |
| As part of the overall stewardship responsibility, the board should assume responsibility for the following matters: | | |
| A. adoption of a strategic planning process | ✓ | The board is actively involved in the Company's strategic planning process. The board discusses and reviews all materials relating to the strategic plan with management. The board is responsible for reviewing and approving the capital spending and general and administrative budgets. At least one board meeting each year is devoted to discussing and considering the strategic plan, which takes into account the risks and opportunities of the business and results are reviewed against the plan at each quarterly meeting thereafter. Management must seek the board's approval for any transaction that would have a significant impact on the strategic plan. |
| B. the identification of the principal risks of the corporation's business and ensuring the implementation of appropriate systems to manage these risks | ✓ | The board, through the Audit Committee, is responsible for identifying the principal risks of the Company and ensuring that risk management systems are implemented. The principal risks of the Company are those related to the environment, prices of oil and gas, declines in production and capital spending. The Audit Committee meets regularly to review reports and discuss the significant risk areas. The board, through the Audit Committee, ensures the Company adopts risk management policies. |
| C. succession planning, including appointing, training and monitoring senior management | ✓ | The board is responsible for selecting the CEO, appointing senior management and monitoring their performance. The board approves the CEO's corporate objectives and compensation of the senior officers. The board supports management's commitment to training and developing of all employees. |
| D. a communications policy for the Corporation | ✓ | The board has adopted a Disclosure Policy to ensure that procedures are in place to provide for the timely and fair dissemination of information to shareholders and potential shareholders and to ensure an adequate response to shareholder inquiries. Shareholders can provide feedback to the Company in a number of ways, including by telephone, email, fax and mail. The communications policy of the Company outlines the procedures for the disclosure of material information, announcements and information to be posted on the Company website. In addition, the board has appointed a continuous disclosure manager. The board reviews and approves the Company's major disclosure documents including the financial statements, management's discussion and analysis, annual and quarterly reports and proxy circulars. |
| E. the integrity of the Corporation's internal control and management information systems. | ✓ | The board through its Audit Committee requires management to implement and maintain appropriate systems of internal control and meets with management to assess the adequacy, integrity and effectiveness of these systems of internal control. The Audit Committee also meets independently with the auditors at least annually following the audit of the financial statements to receive feedback on management's performance with respect to these issues. The board also meets annually with the Company's reserves valuator. |
| 2 & 3. The board should be constituted with a majority of unrelated directors.<br>The board should disclose on an annual basis whether the board has a majority of unrelated directors or, in the case of a Corporation with a significant shareholder, whether the board is constituted with the appropriate number of directors which are not related to either the Corporation or the significant shareholder and the analysis of the application of the principles supporting this conclusion. | ✓ | Of the 7 board members, Peter A. Braaten, Chairman; Raymond R. Pether, CEO and Donald A. Engle, President are related directors. The other four directors are unrelated directors. The Company does not have a significant shareholder.<br>The board is responsible for determining whether or not each director is an unrelated director. To do this, the board analyzes all the relationships of the directors with the Company. The majority of directors are unrelated to the Company. None of the four unrelated directors work in the day-to-day operations of the Company, are party to any material contracts with the Company or receive any fees from the Company. |

| TSX Guidelines for Effective Corporate Governance | | Company Governance Practices |
|---|---|---|
| 4. The board should appoint a committee of directors composed exclusively of outside directors with the responsibility for proposing to the full board new nominees to the board and for assessing directors on an ongoing basis. | ✓ | The board has implemented a procedure whereby the Corporate Governance Committee identifies, evaluates and recommends nominees for the board and assesses directors on an ongoing basis. The Corporate Governance Committee is composed exclusively of unrelated directors.<br>When recruiting new directors, the board will ensure itself that the candidates possess the ability to devote the time required, a willingness to serve, personal qualities, traits and competencies such as integrity, experience and a solid track record as well as financial literacy or other expertise which add value to the board. |
| 5. The board should implement a process to be carried out by the nominating committee or other appropriate committee for assessing the effectiveness of the board as a whole, the committees of the board and the contribution of individual directors. | ✓ | The Corporate Governance Committee monitors, reports on and makes recommendations regarding the effectiveness of the board and its committees including evaluating the frequency, content and attendance at meetings, adequacy of information given to directors, communication processes between the board and management and the strategic processes of the board and its committees. The Committee canvasses the directors to provide feedback for these evaluations and recommends changes to enhance the performance of the board based on the feedback. Such evaluations are carried out annually. |
| 6. The board should provide an orientation and continuing education program for new directors. | ✓ | All new directors receive a comprehensive orientation binder containing a record of historical public information about the Company, as well as the charters of the board and its committees, and other relevant corporate and business information. Senior management makes regular presentations to the board on the main areas of the Company's business. |
| 7. The board should examine its size and establish a board size which facilitates effective decision making. | ✓ | The Corporate Governance Committee reviews the composition and size of the board once a year. In 2003, the committee determined that the board should be increased to 7 members. The board feels that this size is appropriate for a company of its size and complexity. This number of directors permits the board to operate in a prudent and efficient manner. |
| 8. The board should review the adequacy and form of the compensation of directors and ensure the compensation realistically reflects the responsibilities and risk involved in being an effective director. | ✓ | The Corporate Governance Committee reviews directors' compensation at least once a year. To make its recommendation on directors' compensation, the committee takes into account the types of compensation and the amounts paid to directors of comparable Canadian companies. |
| 9. Committees of the board should generally be composed of outside directors, a majority of whom are unrelated directors. | ✓ | The board has two committees, the Corporate Governance Committee and the Audit Committee, both of which are comprised solely of independent and unrelated directors. |
| 10. Each board should assume responsibility for, or assign to a committee of directors, the general responsibility for developing the Corporation's approach to governance issues and respond to the TSX Corporate Governance Guidelines. | ✓ | The Corporate Governance Committee is responsible for reviewing the overall governance principles of the Company, recommending any changes to these principles, and monitoring their disclosure. This committee is responsible for the statement of corporate governance practices included in the Company's annual report. |
| 11. The board, together with the CEO, should develop position descriptions for the board and for the CEO, involving the definition of the limits to management's responsibilities. In addition, the board should approve or develop the corporate objectives which the CEO is responsible for meeting. | ✓ | The board has approved its mandate and a position description for the CEO including the definition of the limits to management's responsibilities. The board approves the corporate objectives and assesses the CEO against these objectives annually. |
| 12. The board should have in place appropriate structures and procedures to ensure that the board can function independently of management. | ✓ | The board has appointed Peter L. Wallace, an independent director as lead director and the board is comprised of a majority of independent directors. Each board meeting allows for the lead director of the board to chair a meeting of non-management directors at which any concerns may be freely expressed. |
| 13. The Audit Committee should be composed only of outside directors and its roles and responsibilities should be specifically defined. The Audit Committee should have direct communication channels with the auditors. The Audit Committee duties should include oversight responsibility for management reporting on internal controls and it is the responsibility of the Audit Committee to ensure that management has designed and implemented an effective system of internal controls. | ✓ | All three members of the Audit Committee are unrelated directors. Messrs McLeish, Thring and Baillie, a chartered accountant, are financially literate (able to read and understand a balance sheet, an income statement, a cash flow statement and the notes attached thereto). The committee's responsibilities are set out in its charter, which is available on our website. The Company's external auditors have a direct line of communication with the committee at all times. The external auditors meet with the committee without management present at least once a year. The committee approves all non-audit work performed by the external auditors. |
| 14. The board should implement a system which enables an individual director to engage an outside adviser at the expense of the Corporation in appropriate circumstances with approval of an appropriate committee of the board. | ✓ | Directors may hire outside advisers at the Company's expense, subject to the approval of the Corporate Governance Committee. No outside advisers were hired by any directors during 2004. |

# Corporate Information

## DIRECTORS & OFFICERS

**Aubrey W. Baillie***
*Director*

**Peter A. Braaten**
*Chairman*

**Donald A. Engle**
*Director and President*

**Robert L. McLeish***
*Director*

**Raymond R. Pether**
*Director and Chief Executive Officer*

**David E. Thring***
*Director*

**Peter L. Wallace**
*Lead Director*

**Robert A. Befus**
*Exploration Manager*

**Mark A. Caranci**
*Chief Financial Officer*

**Jody L. Iles**
*Controller*

**Craig T. Kikuchi**
*Vice President*

**Moyra E. MacKay**
*Corporate Secretary*

**David S. Oginski**
*Chief Operating Officer*

* Member of Audit and Corporate Governance Committee

## AUDITORS

**PricewaterhouseCoopers LLP**
Calgary, Alberta

## TRANSFER AGENT

**CIBC Mellon Trust Company**
Toronto, Ontario

## WEBSITE

www.weltonenergy.com

## MAILING ADDRESS

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T2P 3N3

Phone: 403-233-2393
Fax: 403-264-6219

## CONTINUOUS DISCLOSURE MANAGER

Contact: **Donald A. Engle**
Phone: 403-215-4747
Email: engle@weltonenergy.com

## ABBREVIATIONS

| | |
|---|---|
| **bbl** | barrel |
| **bbls** | barrels |
| **bcf** | billion cubic feet |
| **b/d** | barrels per day |
| **boe** | barrels of oil equivalent |
| **boe conversion ratio** | 6 mcf to 1 bbl |
| **boe/d** | barrels of oil equivalent per day |
| **mbbls** | thousand barrels |
| **mboe** | thousand barrels of oil equivalent |
| **mcf** | thousand cubic feet |
| **mcf/d** | thousand cubic feet per day |
| **mmbtu** | million British thermal units |
| **mmcf** | million cubic feet |
| **mmcf/d** | million cubic feet per day |
| **NGL** | natural gas liquids |
| **WTI** | West Texas Intermediate at Cushing, Oklahoma |

Welton

ENERGY CORPORATION

www.weltonenergy.com

· Calgary, AB.